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No. 96-1944

In the Supreme Court of the United States

OCTOBER TERM, 1996

THOMAS P. NORTON, ET AL., PETITIONERS

v.

FEDERAL TRADE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE FEDERAL TRADE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether sufficient evidence supports the district court's conclusion that petitioners violated Section 5 of the Federal Trade Commission (FTC) Act, 15 U.S.C. 45, in connection with their marketing of greeting card display rack business ventures.

2. Whether sufficient evidence supports the district court's conclusion that petitioners' business arrangements with their customers were "franchises" within the meaning of the FTC's Franchise Rule, 16 C.F.R. 436.

3. Whether the district court properly entered various orders designed to preserve petitioners' assets from dissipation pending trial.

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OPINIONS BELOW

The per curiam order of the court of appeals (Pet. App. 5a-8a) is unpublished, but the judgment is noted at 101 F.3d 707 (Table). The district court's order entering findings of fact, conclusions of law, and permanent injunctive relief (Pet. App. 10a-34a) is reported at 1994-1 Trade Cas. (CCH) ¶ 70,570. The district court's order affording the receiver relief in certain respects (Pet. App. 44a-50a) is unreported.

[1] Although the petition refers to the Federal Communications Commission as the respondent, the agency that has been the party to this case in the lower courts is the Federal Trade Commission.

JURISDICTION

The judgment of the court of appeals was entered on October 29, 1996. A petition for rehearing was denied on February 10, 1997. The petition for a writ of certiorari was filed on May 12, 1997 (a Monday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioners Thomas P. Norton, Jordan Ashley, Inc., Gold Coast Developers, Inc., and National Vending Systems, Ltd., Inc.,[2] were involved in the distribution of greeting cards through business ventures that they marketed to customers. For a payment of between $5,000 and $15,000, petitioners would supply their customers with an initial inventory of greeting cards and display racks. Customers were also informed that a professional locator service would assist them in finding suitable retail locations for the greeting card displays. Pet. App. 19a-20a.

After receiving numerous complaints from customers about petitioners' greeting-card marketing ventures, the Federal Trade Commission (FTC) filed a complaint against petitioners in district court on November 16, 1993. The complaint alleged that petitioners had violated Section 5 of the Federal Trade Commission Act (FTC Act), 15 U.S.C. 45, by making false and misleading representations concerning the greeting card display rack business ventures that

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[2] Patricia Riley, a petitioner in this Court, was not (as relevant here) involved in the business operations of the greeting-card venture and was not one of the original defendants to the complaint brought in district court, but for simplicity we make no further distinction among the petitioners.

they marketed to customers, and the FTC's "Franchise Rule," 16 C.F.R. 436, by failing to provide prospective franchisees with disclosures required by the Rule. The complaint sought monetary relief for injuries suffered by customers as a result of the deceptive trade practices, as well as injunctive relief and the appointment of a receiver.

On December 6, 1993, the district court granted the FTC's request for a temporary restraining order (TRO), appointed a receiver for the corporate defendants, and froze the defendants' assets. On December 8, the receiver, Linda L. Carroll, took control of the corporations' books and offices. In examining the corporate records, Carroll discovered the existence of a condominium purchased with funds from petitioner Gold Coast. She then performed a title search, which revealed that Gold Coast held title to the property, and seized and secured the condominium on December 13.

On December 13, 1993, petitioner Patricia Riley, the wife of petitioner Thomas Norton, moved in district court that the TRO be modified, to permit Riley and Norton to occupy the condominium during the litigation. Riley contended that the condominium belonged to her, not to Gold Coast; her claim was based on a quitclaim deed from Gold Coast to her dated September 21, 1993. Riley, however, had not submitted the deed for recordation until December 9, after she learned of the TRO and the seizure of the corporate offices, and recordation had not been accomplished at the time that the receiver completed her title search. The district court held a hearing on December 15 and then denied Riley's motion, noting that the evidence established that the condominium

had been purchased with funds from Gold Coast. Pet. App. 46a, 48a-49a.

2. On March 8 and 14, 1994, the district court conducted a trial on the merits. The FTC presented testimony from four consumers regarding their experiences with petitioners, from petitioners' tax accountant, who identified tax returns for petitioners Jordan Ashley and Gold Coast Developers; and from the receiver, who described petitioners' corporate structure. The FTC also provided evidence regarding the volume of petitioners' business. Although petitioners cross-examined all the FTC's witnesses, they rested their case without presenting any witnesses of their own, and without introducing any exhibits. See Gov't C.A. Br. 10-11.

On April 5, 1994, the court entered an order concluding that petitioners had violated Section 5 of the FTC Act and the Franchise Rule, and directing relief against petitioners.[3] Pet. App. 10a-34a. As to the Section 5 count, the court ruled that the four consumer-witnesses' testimony, which was "characteristic of those who purchased [petitioners'] business opportunities" (*id.* at 12a), established that petitioners had misrepresented the business opportunities that they marketed to prospective franchisees. The court found specifically that petitioners' representatives would typically represent to investors that they could make substantial sums through the purchase of a distributorship, recouping the initial investment quickly, and that investors could depend on a professional locating company familiar with each

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[3] The court found that there was no real distinction among the corporate petitioners, and that all the petitioners had engaged in the actionable misrepresentations. Pet. App. 11a.

investor's region of the country to obtain suitable retail outlets for greeting-card sales. *Id.* at 12a-13a. In fact, the court found, "[v]irtually all of these statements later proved to be false" (*id.* at 13a); the locating company usually failed to secure adequate outlets for the card racks and proved unwilling to find replacement locations, investors experienced greatly disappointing sales volume and earnings, and franchisees discovered other distributors in the areas in which they had been promised exclusive distribution rights. *Id.* at 13a-14a.

The court also concluded, based on the same evidence, that petitioners' business arrangements with their customers constituted "franchises" within the meaning of the FTC's Franchise Rule, which requires "a franchisor to provide prospective franchisees with a complete and accurate disclosure containing twenty categories of information." Pet. App. 17a. Under the Rule, a business arrangement may be a "franchise" if (a) the franchisee sells goods or services identified with the service mark of the franchisor, and the franchisor gives "significant assistance" to the franchisee in marketing plans and promotional activities, or (b) the franchisee sells goods or services supplied by the franchisor, and the franchisor provides the services of a person able to secure retail outlets for rack displays. *Id.* at 18a-19a; see 16 C.F.R. 436.2(a)(1)(i) and (ii). The court found that the evidence introduced at trial satisfied both tests for a franchise arrangement, and in particular that petitioners "gave purchasers substantial assistance in operating their distributorships," and that petitioners "insisted that [customers] use a professional locating company specified by [petitioners] in order to select the locations for their [greeting-card] rack

displays." Pet. App. 19a. The court also found that petitioners required their customers to pay fees of substantial amounts, between $5,000 and $15,000, "in order to acquire their initial sets of racks and cards, without which they could not have commenced operation of their card distributorships." *Id.* at 20a.

The district court granted injunctive relief and required petitioners to pay more than $9 million in redress. The court also continued the receivership and ordered the receiver to formulate a plan to satisfy petitioners' liability. To facilitate redress, the court directed petitioners to transfer title to the condominium to the receiver. Pet. App. 20a-30a.

3. On appeal, petitioners challenged the entry of the TRO (permitting seizure of the corporate offices), Pet. C.A. Br. 18-34, the district court's denial of attorney's fees from petitioners' seized funds to defend the action, *id.* at 35-45, the entry of the injunction against a related corporation, *id.* at 45-48, and the seizure of the condominium, *id.* at 48-54. Petitioners did not, however, specifically challenge the factual basis for the district court's findings of liability under either Section 5 of the FTC Act or the Franchise Rule. The court of appeals summarily affirmed. Pet. App. 5a-8a.

ARGUMENT

Petitioners argue (Pet. 20-28) that the evidence does not support the district court's conclusion that they violated Section 5 of the FTC Act and the FTC's Franchise Rule. Those arguments, however, were not raised in petitioners' principal brief in the court of appeals, and, accordingly, have been waived. *Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 644-645 (1992). The arguments are in any event without merit, as is petitioners' summary contention (Pet. 28-29) that

they were denied a fair opportunity to present their case to an impartial court. Further review is therefore not warranted.

1. Petitioners contend that evidence presented to the district court did not demonstrate violations of Section 5 of the FTC Act and did not establish that the business opportunities they sold were "franchises" under the FTC's Franchise Rule. Pet. 20-28. The evidence presented to the district court, however, fully supports that court's conclusions.

As to the violation of Section 5 of the FTC Act, the district court based its conclusions on the testimony of six witnesses presented by the FTC at trial, including four customers whose experiences it found to be "characteristic" of those who purchased petitioners' business opportunities. Pet. App. 12a. Those customers testified, and the district court found, that petitioners represented that an investor could expect to make substantial sums through a distributorship, often up to $50,000 per year; that an investor could recoup his initial investment quickly, within six months; and that each investor would have the right to operate as an exclusive distributor within his territory. *Ibid.* "Virtually all of these statements later proved to be false." *Id.* at 13a.

As to the violation of the Franchise Rule, the customer witnesses testified that petitioners' representatives assured them that "a 'professional locating company' familiar with each investor's region of the country would find retail outlets suitable for card sales and willing to accept card display racks." Indeed, petitioners' representatives insisted that their customers defer to the locating companies in choosing retail outlets. The assurances of substan-

tial assistance from the professional locator service also proved false. Pet. App. 13a.

Based on that testimony, the district court was fully justified in concluding that petitioners violated Section 5 of the FTC Act and the Franchise Rule. Petitioners argue, however, that the customers' testimony was based on vague recollection, that the FTC excessively prepared those witnesses for trial, and that the testimony was "tailored by the direct line of questioning by the FTC's attorneys," Pet. 24. Petitioners had ample opportunity to, and did, cross-examine each of the FTC's witnesses. None of petitioners' challenges to the witnesses' testimony demonstrates that any of the district court's specific factual findings was clearly erroneous, see *Anderson* v. *City of Bessemer City*, 470 U.S. 564, 573-575 (1985), or presents an important legal issue warranting this Court's review.

Petitioners' contentions based on its summary of handwritten consumer complaints received by the FTC, see Pet. 22-28; Pet. App. 53a-54a, are irrelevant. The handwritten complaints were included with the evidence presented to the court in support of the FTC's motion for a TRO. The district court's final judgment, however, was based on the live testimony of witnesses at trial, and not on the TRO evidence. Petitioners were, moreover, free to show at trial that the customers who testified did not have experiences that were characteristic of petitioners' franchisees, but they failed to produce any evidence to support their case.

2. There was also no error in any of the orders entered by the district court to preserve petitioners' assets pending trial.

a. Nothing in the Federal Rules of Civil Procedure or the two statutes cited by petitioners precluded the court from entering a TRO *ex parte* against petitioners. See Pet. 20-21, 28. Federal Rule of Civil Procedure 65(b) expressly contemplates that a TRO may be entered *ex parte* in certain circumstances. See Fed. R. Civ. P. 65(b) ("A temporary restraining order may be granted without written or oral notice to the adverse party or that party's attorney.").

There is also no basis for petitioners' argument that Section 13(b) of the FTC Act, 15 U.S.C. 53(b), precludes entry of such a TRO. Section 13(b) provides that, "in proper cases the Commission may seek, and after proper proof, the court may issue, a permanent injunction." The courts of appeals that have interpreted Section 13(b) have all held that it does not restrict the equitable powers of the district court, and that it authorizes the court to employ its full complement of inherent equitable powers when enforcing the FTC Act, including the power to grant provisional injunctive relief. See *FTC* v. *Security Rare Coin & Bullion Corp.*, 931 F.2d 1312, 1314 (8th Cir. 1991) (rescission); *FTC* v. *World Travel Vacation Brokers, Inc.*, 861 F.2d 1020, 1026 (7th Cir. 1988) (preliminary injunction); *FTC* v. *U.S. Oil & Gas Corp.*, 748 F.2d 1431, 1434 (11th Cir. 1984) (asset freeze, appointment of receiver); *FTC* v. *H. N. Singer, Inc.*, 668 F.2d 1107, 1111, 1113 (9th Cir. 1982) (rescission). Indeed, as this Court has explained, the comprehensiveness of the district court's equitable jurisdiction "is not to be denied or limited in the absence of a clear and valid legislative command." *Porter* v. *Warner Holding Co.*, 328 U.S. 395, 398 (1946). No such limitation exists in the FTC Act. Accordingly, there can be no doubt about the district

court's authority to grant an *ex parte* TRO in a proper case.

Nor does 28 U.S.C. 636(b)(1)(C) preclude the FTC from seeking an *ex parte* TRO. That Section provides that, when a matter has been submitted by a district court judge to a magistrate judge for a recommendation, the magistrate judge "shall file his proposed findings and recommendations * * * with the court and a copy shall forthwith be mailed to all parties." Petitioners contend that, because the district judge referred the FTC's motion for a TRO to a magistrate judge, Section 636(b)(1)(C) required the magistrate judge to notify petitioners of his recommendations. Nothing in the language of Section 636 indicates, however, that magistrate judges must give notice in matters that a district judge could properly dispose of *ex parte*. See *Eatable Greetable Products, Inc.* v. *Sweet Stop Inc.*, 627 F. Supp. 777, 779-780 (D. Mass. 1986) (noting that magistrate had recommended entry of *ex parte* TRO).

b. Petitioners incorrectly argue they were entitled to pay their attorneys from funds frozen to preserve the possibility of redressing injured consumers. See Pet. 29. In fact, there is no such right. "Courts regularly have frozen assets and denied attorney fees or limited the amount of attorney fees." *FTC* v. *World Wide Factors, Ltd.*, 882 F.2d 344, 347 (9th Cir. 1989) (citing *United States* v. *Monsanto*, 491 U.S. 600, 614 (1989), and *Caplin & Drysdale, Chartered* v. *United States*, 491 U.S. 617, 626 (1989) (no constitutional right to use frozen funds for attorney's fees, even in a criminal case)). To the extent that petitioners suggest that *United States* v. *Moya-Gomez*, 860 F.2d 706 (7th Cir. 1988), cert. denied, 492 U.S. 908 (1989), entitles them to use frozen funds to pay attor-

ney's fees, Pet. 29, they misread that case, which held only that due process requires that an adversary hearing be held before the government "may by forfeiture continue to deprive a criminal defendant of assets to pay attorneys in a criminal case." *United States* v. *Michelle's Lounge*, 39 F.3d 684, 691 (7th Cir. 1994).

c. Finally, there is no merit to petitioners' contention (Pet. 29) that the receiver's seizure of the condominium was unconstitutional because petitioners did not receive a pre-seizure or prompt post-seizure hearing. In fact, the court held an adversary hearing on the matter on December 15, 1993, two days after the seizure. See Pet. App. 44a-50a. Further, as this Court stated in *United States* v. *James Daniel Good Real Property*, 510 U.S. 43 (1993):

> *Unless exigent circumstances are present*, the Due Process Clause requires the Government to afford notice and a meaningful opportunity to be heard before seizing real property subject to civil forfeiture. * * * To establish exigent circumstances, the Government must show that less restrictive measures—*i.e.*, a *lis pendens*, restraining order, or bond—would not suffice to protect the Government's interests in preventing the sale, destruction, or continued unlawful use of the real property.

Id. at 62 (emphasis added).[4] Here, exigent circumstances justified the pre-hearing seizure of the condominium. The condominium contained corporate

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[4] *James Daniel Good Real Property* was decided on December 13, 1993, the same day that the receiver occupied the condominium.

property and books that were being hidden from the receiver and could have been destroyed. Pet. App. 46a. Further, by the time of the seizure, the receiver, who is obligated to protect the corporate assets, already knew that petitioners were attempting to destroy evidence and secrete assets. *Id.* at 45a. A *lis pendens* or bond could not have adequately assured that petitioners would not take such actions. In addition, petitioners were already subject to a restraining order and had violated it by withdrawing frozen funds. *Id.* at 46a-47a. Thus, the seizure of the condominium did not deny petitioners due process.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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